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The Manufacturers Hanover
Financial Digest

Weekly Commentary, Selected Financial Data, and Business Indicators

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An Exuberant Economy . . .

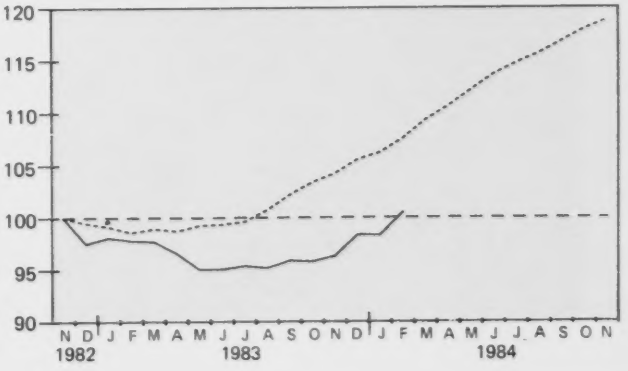
Because of the release of a flurry of upbeat business statistics, fears have mounted that the rate of inflation will accelerate and that the Federal Reserve will be forced to tighten the monetary reins as a result. Not surprisingly, credit market sentiment has deteriorated sharply in recent weeks—sending interest rates higher and long-term investors scurrying for cover. But one wonders if the news is really all that bad, or if the skittishness of the financial markets is more a reflection of fears rather than actual events. Indeed, contrary to conventional wisdom, a case can be made that the recent rise in interest rates may be enough to dampen business activity sufficiently to avoid an overheating of the economy.

Take, for example, the economy. If the credit markets are right about anything, it is their perception that the business expansion remains solidly on track. Despite a modest dip in retail sales in February, month-over-month, almost all other business indicators remain healthy. According to the Commerce Department's "flash" GNP report, the economy expanded at an inflation-adjusted 7.2 percent seasonally adjusted annual rate in the first quarter, well above the five percent annual rate pace of the fourth quarter. This is hardly surprising, since housing starts and auto sales are running at their highest levels since the late 1970s, and solid gains continue to be posted in both total employment and personal incomes. In addition, the business sector is becoming an increasingly important source of economic strength. Industrial output continues to climb, business inventory-to-sales ratios remain at exceptionally low levels and, with capacity utilization rates surpassing 80 percent last month, business capital spending and future spending intentions have moved sharply higher.

. . . Plus A Jawboning Fed . . .

But herein lies the rub. As capacity constraints emerge, not only will the risk of an accelerating rate of inflation increase but, as business outlays expand and cash flow growth slows, corporate America's borrowing needs will begin to revive—adding to upward pressures on interest rates. Already, during the latter half of 1983, business spending for inventories, plant and equipment once more outpaced business cash flow, following a three-quarter period in which cash flow exceeded such outlays by the widest margin in the postwar era. Indeed, the evaporation of the corporate surplus in late 1983 has, as shown in the chart below, prompted a revival of short-term business credit demands. If the past is any guide, that stage of the business cycle has now been reached in which bank loans and commercial paper outstanding will increase—and rapidly at times. This, of course, raises the specter that unless Washington's borrowing needs are reduced, interest rates as well as inflation rates may soon be leaping higher.

SHORT-TERM BUSINESS CREDIT OUTSTANDING: CURRENT RECOVERY (LINE) VS. AVERAGE OF PRIOR 7 RECOVERIES (DOT) <TROUGH=100>



Nonetheless, the pessimistic assessment by the credit markets of the future course of both inflation rates and interest rates may be unwarranted. To be sure, over the past three months, producer prices have advanced at an approximately five percent seasonally adjusted annual rate (compared with a less than one percent seasonally adjusted annual rate of rise during the immediately preceding three months)—a development believed by some to be the start of a prolonged, upward trend. However, this may not be the case.

For one thing, severe winter weather had a pronounced effect on food and energy prices. Once

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these two components are eliminated from the price index, the rise in producer prices over the last three months slows from almost five percent to less than three percent—not bad when you consider that the recovery is well into its second year. What is more, despite the rise in commodities prices, it still appears a good bet that the rate of inflation will remain modest in 1984. This is because labor costs are unlikely to rise sharply, given the ongoing commitment of corporate America to cost-cutting and, even when they do, productivity improvements will offset much of their inflation impact. As long as the rise in labor costs per unit of output remains modest, so, too, will the underlying rate of inflation.

. . . Equals Higher Interest Rates

Nor should recent money supply trends add to the bearishness overhanging the credit markets. Both the M1 and M2 money supply numbers are within their specified 1984 target boundaries, a development which would seem to suggest that the Fed has been neither overly generous nor, for that matter, overly restrictive in supplying reserves to the banking system. What all this adds up to is that if some of the exuberance could be taken out of the business expansion, prospects for a prolonged and steep rise in interest rates would abate.

But how can the economy be slowed without

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/21/84	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	158.455	+ .671	+13.203
Loans to Depository Inst.	1.077	+ .191	+ .436
Float	1.091	– .684	– 1.007
Total Reserve Bank Credit	169.316	+ .288	+12.272
Treasury Deposits with Federal Reserve Banks	5.327	+ 2.502	+ 1.940
Currency in Circulation	168.551	+ .025	+13.780
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	114.867	– 1.778	+ 3.271
	3/14/84		
Member Bank Reserves:			
Total Reserves Held	35.680	+ .646	– 2.100
Excess (Deficiency)	.694	– .039	+ .283
Net Borrowed Reserves	.038	+ .372	– .071
Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1 (3/12/84)	536.1	‡	‡
M2 (February '84)	2,221.9	+ 7.3	+ 8.2
M3 (February '84)	2,742.7	+ 8.0	+ 9.0
Domestic Nonfinancial Debt (4th Q'83)	5,219.0	+ 10.6	+ 10.8

†Seasonally adjusted.

*Seasonally adjusted annual rate.
‡Data unavailable due to revisions.

New York Money Market

Offering Rates 3/23/84	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	9.75%	9.90%	9.90%
* Federal Agencies	10.30	10.65	10.90
* Project Notes—Taxfree (46% Taxable Equivalent)	9.44	11.02	11.11
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	10.40	10.72	11.00

‡Finance Company Paper—Prime

5- 14 days	10.05%
15- 29 days	10.25
30- 59 days	10.15
60- 89 days	10.00
90-179 days	9.90
180-239 days	9.90
240-270 days	9.50

‡* Bankers' Acceptances

Apr.	10.20%
May	10.20
Jun.	10.20
Jul.	10.30
Aug.	10.30
Sep.	10.25

‡Industrial Paper—Prime

30- 89 days	10.15%
90-120 days	10.20

†Federal Funds Effective Rate 10.30%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'83	$ 3,436r	$ 3,362	$ 3,110
Gross National Product (1972 Dollars)*	4th Q'83	$ 1,573r	$ 1,553	$ 1,481
Percent Change, Annual Rate	4th Q'83	5.0r	7.6	– 1.3
Change in Consumer Prices (new series)*	Feb '84n	4.8%	7.2%	– 1.2%
Change in Producer Prices*	Feb '84	4.8%	7.2%	1.2%
Civilian Employment (Thousands of Persons)†	Feb '84	103,892	103,190	99,172
Unemployment as % of Civilian Labor Force†	Feb '84	7.8%	8.0%	10.4%
Personal Income*	Feb '84n	$ 2,923	$ 2,902r	$ 2,651
Leading Indicators Composite Index (1967=100)†	Jan '84	164.7	162.9	145.2
Industrial Production Index (1967=100) †	Feb '84	159.1	158.0	138.1
Net Change in Consumer Installment Credit †	Jan '84	$ 4.34	$ 6.61	$ 2.73
U.S. Merchandise Trade Balance †	Jan '84	–$ 9.47	–$ 6.74	–$ 3.84
Plant and Equipment Expenditures*	2nd Q'84	$335.40(a)	$332.66(a)	$293.46
Private Housing Starts (Thousands of Units)*	Feb '84	2,197	1,976	1,706
New Construction Expenditures*	Jan '84	$ 281.8	$ 277.8	$ 247.9
Total Business Inventories †	Jan '84	$ 522.7	$ 520.7	$ 507.6
Total Business Sales †	Jan '84	$ 402.0	$ 396.7	$ 345.3

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

the Fed actively tightening the money reins? One method would be for the Fed to initiate a policy of word, rather than deed: namely, jawbone the financial markets to get them, rather than the central bank, to do the unpalatable job of cooling off the economy. And, indeed, by repeatedly warning of the negative effects that a too strong economy will have on inflation and interest rates, Fed Chairman Paul A. Volcker has encouraged the markets to boost yields and thereby depress business activity and stock prices. This was accomplished without the Fed having to alter the rate of growth of money and credit.

The degree of success encountered by these actions in dampening today's business exuberance will largely determine whether or not a rapid runup in interest rates can be avoided this year. And, with Washington's budget deficit running below expectations due to stronger-than-anticipated revenue growth and lower-than-expected spending levels, it is not inconceivable that, with any luck at all, the combination of a slower pace of business and more modest-than-projected Treasury borrowings could keep interest rates from rising too rapidly, thus setting the stage for a third year of economic growth. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Time Deposits of $100,000 or more Weekly Reporting Banks			
Nationwide (3/7/84)	142,696	+ 1,146	–16,776
New York City (3/14/84)	29,448	– 35	– 9,276
Commercial Paper (3/14/84)	196,372	+ 3,455	+29,316

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/7/84)	228,384	+ 1,567	NA*
New York City (3/14/84)	59,560	+ 20	NA*

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/7/84)	583,124	– 2,228	NA*
New York City (3/14/84)	131,600	+ 799	NA*

*Year ago data not available due to definitional changes.

Financial Markets

	Friday 3/23/84	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	10.15%	+ .46	+ 1.35
180-Day Bills†	10.59	+ .47	+ 1.59
Longest Bills†	10.91	+ .53	+ 1.73
Recent Issues:			
10⅞s 2/28/86	11.63	+ .51	
11¼s 12/31/87	12.03	+ .61	
11¾s 11/15/93	12.44	+ .26	
12s 8/15/13	12.52	+ .21	
Municipals:			
Bond Buyer–20 Bond Index* (3/22/84)	10.01%	+ .03	+ .86
Blue List Total ($ Million)	$1,432	+$ 23	+ $ 44
30-Day Visible Supply ($ Million)	$2,349	–$ 226	– $2,431
Total	$3,781	–$ 203	– $2,387
Corporates:			
Moody's Aa Composite (3/22/84)	13.35%	+ .12	+ 1.07
30-Day Visible Supply ($ Million)	$ 405	–$3,090	– $ 642
Stocks:			
Dow-Jones Averages:			
Industrials	1,154.84	– 29.52	+ 8.94
Transportation	503.19	– 15.02	– 16.51
Utilities	126.88	– .72	+ .59
65 Stocks	452.67	– 10.81	– 1.05
Standard and Poor's 500 Stocks	156.86	– 2.41	+ 3.49
N.Y.S.E. Composite Index	90.35	– 1.38	+ 2.15
N.Y.S.E. Avg. Daily Vol. for Week (000's)	81,040	–11,630	– 3,830

* 46% Taxable equivalent 18.54%.

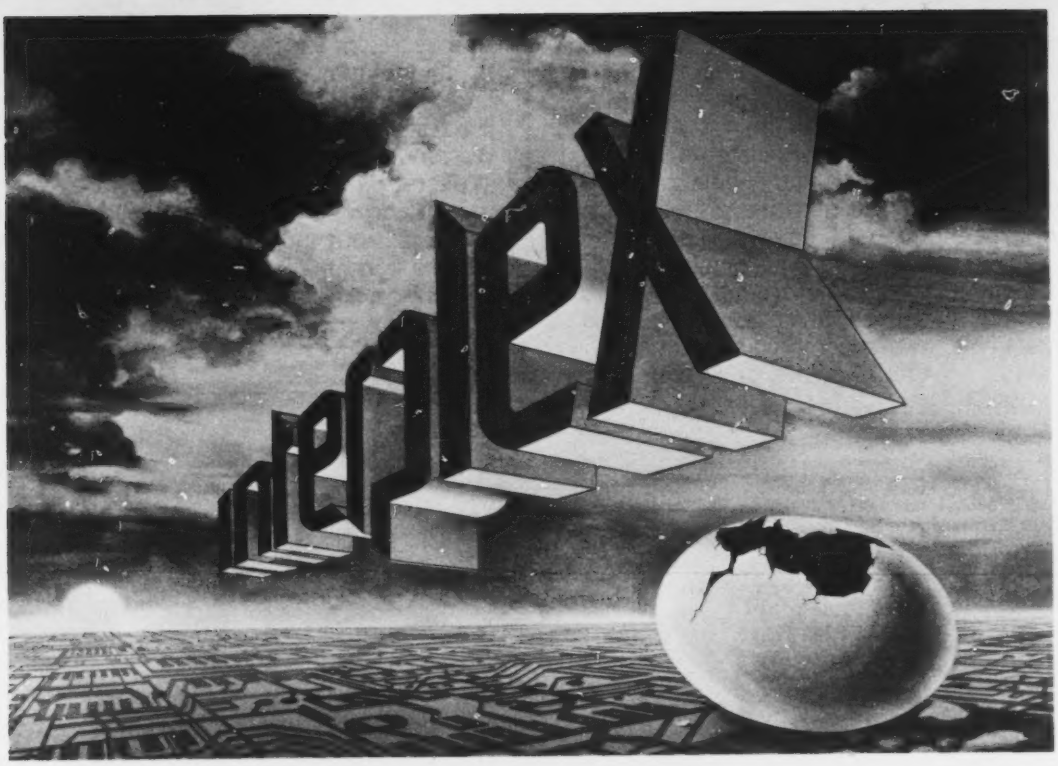
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 3/23/84	Week Ago
Overnight	10.25%	9.88%
1 month	10.63	10.06
3 month	10.75	10.31
6 month	11.06	10.63
1 year	11.56	11.00
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	12.20%	12.00%
Long Term (7 to 15 yrs.)	12.30	12.20

FOREIGN EXCHANGE SPOT RATES

New York Opening (3/23/84)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.01854	53.93
Canada	.7838	1.2758
Denmark	.1033	9.6825
France	.1230	8.1275
Germany	.3794	2.6355
Italy	.0006136	1629.80
Japan	.004418	226.35
Mexico	.005764	173.50
Netherlands	.3363	2.9735
Switzerland	.4591	2.1783
U.K.	1.4283	.7001



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